

***United States Court of Appeals
for the Second Circuit***



**PETITIONER'S
BRIEF**

13
P/S

77-4146

United States Court of Appeals
FOR THE SECOND CIRCUIT

LLOYD CARR & CO., LLOYD CARR FINANCIAL CO., JAMES A.
CARR AND CHARLES P. LEMIEUX III,

Petitioners,

against

COMMODITY FUTURES TRADING COMMISSION,

Respondent.

**Petition for Review of Order of the
Commodity Futures Trading Commission**

PETITIONERS' BRIEF

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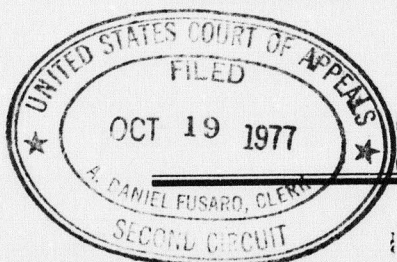


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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Docket No. 77-4146

LLOYD CARR & CO., LLOYD CARR FINANCIAL CO.,
JAMES A. CARR and CHARLES P. LEMIEUX III,

Petitioners,

-against-

COMMODITY FUTURES TRADING COMMISSION,

Respondent.

PETITIONERS' BRIEF

Preliminary Statement

This brief is submitted on behalf of all of the Petitioners in the above-captioned action in support of their petition for review of a final order of the Commodity Futures Trading Commission (the "Commission") dated August 1, 1977 (CFTC Docket No. 77-6), (i) refusing to grant Petitioners a Futures Commission Merchant ("FCM") license to engage in the trading of "London" commodity options,* (ii)

* A "London option" is an option on a commodity traded on the London Metals Exchange or a variety of other exchanges that clear their trades through the International Commodity Clearing House in London, England. On and after January 17, 1977, a dealer in such
(Footnote continued)

revoking Petitioners Commodity Trading Advisor ("CTA") license and (iii) imposing other sanctions. The Commission imposed these severe sanctions on the grounds that Lloyd Carr (i) had done business after January 17, 1977 while not yet registered as an FCM and had permitted certain of its sales personnel to do likewise while not yet registered as "associated persons," and (ii) allegedly "refused" to permit a second audit of its books and records one week after two Commission auditors had completed a two day audit of these same books and records.

As described in detail herein, the Commission's final order should be vacated because:

(1) The licensing hearing held by the Commission below was improperly terminated depriving the Petitioners of due process of law.

(2) Petitioners fairly met the requirements for an FCM license on January 17, 1977, the first day on which they were required to be so registered; and are entitled to continue doing business; and

(Footnote continued)

options was required to be registered as an FCM, pursuant to new regulations of the Commission governing the previously unregulated commodity options business. This Court reviewed the nature of the commodity options business and the Commission's new regulations in detail in its recent decision in British American Commodity Options Corp. v. Bagley, 552 F.2d 482 (2d Cir. 1977), petition for cert. filed, 26 U.S.L.W. 3017 (U.S. July 15, 1977) (No. 77-96), in which Lloyd Carr was a principal party.

(3) The Commission's determination to impose the ultimate sanction of denial of a license -- which effectively deprives Petitioners and their several hundred employees of their right to earn a livelihood as commodity options dealers -- was unduly harsh, abusive and discriminatory particularly in view of the fact that the Commission expressly found that (i) Petitioners had not engaged in fraud, manipulation or breach of fiduciary responsibilities and (ii) Petitioners' conduct had had no adverse impact on trading in any contract market. In selecting these sanctions the Commission improperly sought to make an "example" of Petitioners. The Commission's sanctions are wholly unrelated to the Commission's duty to protect the public, and its claim that its sanctions are warranted because Petitioners "flout[ed] the law" is based upon a view of the facts that is against the manifest weight of the evidence.

For the reasons set forth herein, we submit that the Commission denied Petitioners due process of law, and erred in its refusal to issue Petitioners an FCM license, and in its imposition of other sanctions.

Jurisdiction

Petitioners' petition for review was filed with this Court pursuant to 7 U.S.C. §§ 9 and 12 on August 4, 1977. The final order of the Commission here sought to be reviewed is dated August 1, 1977.

Issues Presented For Review

1. Did the Commission violate Petitioners' right to due process of law by summarily terminating the hearing below?

2. Did the Petitioners fairly meet the requirements for issuance of a license as an FCM on January 17, 1977, the date upon which such license was first required and properly continue to do business thereafter?

3. Did the Commission err in determining that Petitioners' technical violations warranted a finding that they had "flout[ed] the law" and exhibited "callous disregard" therefor?

4. Was the drastic sanction of denial of a license proper where Petitioners have committed no "fraud, manipulation or breach of fiduciary responsibility" and where the severe sanctions imposed were selected to make Petitioners an "example" to a newly regulated industry?

Statement of the Case

A. The Petitioners and Their Business

In late July or early August, 1976, Petitioners James A. Carr ("Carr") and Charles P. LeMieux III ("LeMieux") formed Lloyd Carr Financial Co. ("Financial"), a Massachusetts partnership with its principal place of business in Boston, for the purpose of engaging in the business of selling London options. (Tr. 222-224, 226; A-406-408,

410)* Although Carr and LeMieux used the names "Lloyd Carr & Co." and "Lloyd Carr Financial Co." "interchangeably" in the course of their business as options dealers, the entity that was engaged in the options business was always the Carr/LeMieux partnership. (Tr. 224; A-408)** On or about January 25, 1977, at the request of the Commission Staff and to eliminate any confusion, the Carr/LeMieux partnership adopted the name "Lloyd Carr & Co." exclusively for all business purposes. (Tr. 223, 677; A-407, 860)

For clarity, and because that business is today known as Lloyd Carr & Co., all references to Petitioners' options business herein will be to "Lloyd Carr."***

* The notation "Tr." refers to the separately numbered pages of the transcript of the hearing below, which comprises Volumes II and III (pages 185-1001) of Petitioners' Appendix herein. The notation "A" denotes a parallel citation to the pages of the Appendix itself.

** The Commission's August 1, 1977 Opinion below attempts to suggest that Lloyd Carr and Financial were two separate entities both of which were engaged in the options business. (Opinion at 9; A-133). However, the record is very clear that, in fact, there was only one partnership that sometimes used two names. (Tr. 222-224; A-406-408). The Commission recognizes this fact in its Opinion pp. 49-50, fn. 53.

*** Before Carr formed the partnership with LeMieux he formed Lloyd Carr & Co., a sole proprietorship (Tr. 222; A-406), but after going into business with Le-
(Footnote continued)

B. Lloyd Carr's Initial Operations and Its Training Program

Upon forming their partnership in late July or early August 1976, Carr and LeMieux applied to the Commission for registration as a Commodity Trading Advisor ("CTA"), a classification covering persons advising others as to the value of commodities or the advisability of trading in them. (Tr. 524-525; A-707-708)* The Commission granted the partners' application for CTA status on November 20, 1976. (Tr. 524; A-707)

The new partners also set about building a sales force and training new salespersons in the commodity options field. All salespersons were required to undergo an intensive training program, consisting of the study of extensive documentary materials and lectures by experienced salespersons and other individuals with expertise in the

(Footnote continued)

Mieux, Lloyd Carr & Co. became dormant. (Tr. 222-224; A-406-408) It existed, essentially, as nothing more than a bank account into which Carr deposited his partnership distributions and which he used as his personal account. (Tr. 326; A-509) This sole proprietorship is not to be confused with Financial or its successor, Lloyd Carr.

- * While the Commission at that time had no regulation expressly requiring commodity options dealers to be registered, an interpretive release published on October 22, 1975 stated, "[g]enerally, persons who are offering commodity options to the public are required to register" as CTAs. 40 Fed. Reg. 49,360, at 49,361 n.11 (1975).

commodities field, before being permitted to contact any prospective customers. Subsequently, salespersons were permitted to contact customers in a "monitored" environment with experienced salespersons overseeing their sales presentations. (Tr. 38-40, 81-82, 769-772; A-222-224, 265-266, 952-955) This closely supervised sales training program, which is ongoing (Tr. 58; A-242) may explain why Lloyd Carr has been so successful in serving the public. (Tr. 231; A-415)*

C. The October 1, 1976 Filing

On October 1, 1976 Lloyd Carr, in the name of Lloyd Carr Financial Co., filed an application with the Commission's New York Eastern Regional Office for registration as a futures commission merchant. (Tr. 510, DX 9(a);** A-694, 1007) The Lloyd Carr application was accom-

* At the hearing below, the Commission called as a witness one of the few Lloyd Carr customers who had had a complaint. (Tr. 111 et seq; A-295 et seq.) He testified unequivocally that his complaint had been promptly rectified to his complete satisfaction (Tr. 124-125; A-308-309), and that he had found the Lloyd Carr personnel with whom he had dealt to be capable and honest. (Tr. 140-141; A-324-325) He added that he was satisfied with the service he had received from Lloyd Carr and that he wished to continue doing business with the firm. (Tr. 141; A-325)

** The notations "DX" and "RX" were used to indicate exhibits of the Commission's Division of Enforcement and of Petitioners (respondents below), respectively, in the hearing below. That nomenclature is adopted here. The exhibits themselves are collected in Volume IV of Petitioners' Appendix herein.

panied by a check in the required amount of \$200 which was cashed by the Commission, and has been retained by it. (Tr. 538, RX 10; A-721, 1064)

Subsequently, the Commission returned the application to Lloyd Carr's Boston office, along with, according to the Commission, a standard form deficiency letter dated October 12, 1976.* (Tr. 510-511, 513-516, DX 10; A-694-695, 697-700, 1011) Lloyd Carr contends that it did not in fact receive the deficiency letter until late December when its then counsel obtained a copy from the Commission.**

D. The January 17, 1977 Filing

On and after January 17, 1977, pursuant to Section 32.3 of the Commission's new regulations (17 C.F.R. § 32.3 (1977)), a commodity option dealer was required to be registered as an FCM in order to engage in the solicitation

* The Commission's Mr. Cooper testified that Lloyd Carr's application was deficient in that it did not include the necessary financial statement and biographical information form (Tr. 510-511; A-694-695). However, he acknowledged that the biographical information required for FCM registration is identical to that required for CTA registration (Tr. 524, 527, 533; A-707, 710, 716) and that such information was submitted by Carr and LeMieux on October 21, 1976 in connection with their CTA application. (Tr. 534, 536; A-717, 719)

** Lloyd Carr's director of operations stated unequivocally that he never received the October 12 deficiency letter although he opened all mail delivered to Lloyd Carr's Boston office. (Tr. 749; A-932)

of orders for, sales of, and acceptance of monies in payment for commodity options. The Commission stated in a release published on January 19, 1977 (42 Fed. Reg. 3699, at 3701 (1977)) that registration was granted to all applicants who (i) met the minimum adjusted working capital requirements* and (ii) satisfied the Commission's fitness requirements.**

On January 17, 1977 Lloyd Carr (in the name of Lloyd, Carr Financial Co.) resubmitted its October 1, 1976 FCM application form to the Commission's New York office. The application was complete (DX 9(a); A-1007) and it was receipt stamped at 9:34 a.m. As the record below demonstrates, Lloyd Carr fully met the requirements for licensing as an FCM on January 17, 1977.

E. The Commission's Audit and its Aftermath

On January 20 and 21, two auditors from the Commission's Office of Audit and Financial Review, Division of Trading and Markets conducted an audit at Lloyd Carr's office in connection with Lloyd Carr's resubmitted FCM

* Maintenance of adjusted working capital in excess of the greater of \$50,000 or a formula figure, one of whose components is five percent of the dealer's aggregate indebtedness (17 C.F.R. § 1.17 (1977))

** See 7 U.S.C. § 12a and the Commission's July 3, 1975 interpretive release, 40 Fed. Reg. 28,125 (1975), which discussed in Point II, infra.

application. (Tr. 275, 304, 365-366; A-459, 488, 548-549)
All of Lloyd Carr's books and records were made available to the auditors (Tr. 370; A-553), who were permitted to make copies of anything they liked. (Tr. 310, A-494)
Lloyd Carr's accountants, who were present throughout the audit, prepared backup schedules and collected such other data as the auditors requested. (Tr. 370-371; A-553-554)

Although the Commission claimed that Lloyd Carr did not have certain accounting records such as a trial balance and cash receipt and disbursement journals (Tr. 372, 383-384; A-555, 566-567) the Commission's auditors nonetheless were able to determine, based upon the available records, that Lloyd Carr met, by nearly twice, the minimum adjusted working capital required by the new regulations. (Tr. 421, 495-496, 678-679; A-604, 679-680, 861-862)*

On January 20, 1977, in connection with the audit,

* Although the Commission now attempts to make much of the state of Lloyd Carr's records (Opinion at 35 et. seq.; A-159 et. seq.), neither the Commission nor its auditors claimed that the underlying information required to be kept by options dealers pursuant to 17 C.F.R. § 32.7 was not kept by Lloyd Carr. Moreover, the Commission deliberately did not send Lloyd Carr the customary deficiency letter advising it that its books and records were not acceptable. (Tr. 411, 690; A-594, 873) This Court has held that, absent such a letter, sanctions should not be imposed. Economou v. United States Dep't of Agriculture, 494 F.2d 519 (2d Cir.1974).

the Lloyd Carr accountants prepared and delivered to Ms. Chan, the Commission auditor in charge of the audit, a new financial statement which made certain adjustments in the financial statement filed January 17, and further confirmed Lloyd Carr's compliance with the Commission's working capital requirements. (Tr. 374, DX 24; A-557, 1031) Indeed, at the hearing below, counsel for the Commission stated that Lloyd Carr was "not in any way charged with failing to meet the minimum financial requirements." (Tr. 447; A-631. See also Tr. 421, 484; A-604, 668)

Aside from maintaining sufficient working capital, the only other requirement for FCM registration was that an applicant meet the Commission's fitness standards. (42 Fed. Reg. 3699, at 3701 (1977)) In connection with Lloyd Carr's prior application for CTA status, the Commission had previously found that Lloyd Carr and its principals met its fitness standards. (Tr. 524, 525; A-707, 708) The fitness requirements for CTA and FCM registration are identical, as acknowledged by one of the Commission's witnesses. (Tr. 524, 533; A-707, 716) Thus, it is clear that, as of January 17, 1977 Lloyd Carr met both requirements for licensing as an FCM.

Carr testified that, at the conclusion of the audit, Ms. Chan told him that he could call the Commis-

sion's New York office Monday morning, January 24, 1977 to "get the good news" that Lloyd Carr's FCM application had been approved. (Tr. 306; A-490) Not surprisingly, Ms. Chan denied having gone so far, but she did admit that she had told Carr that Lloyd Carr met the working capital requirements and that if the financial and "registration" parts of Lloyd Carr's application were approved, and if the Commission's Division of Enforcement had "nothing against him," "then he would be registered," and he could call on Monday morning to "confirm that[,] so they can go on [doing] business." (Tr. 496-497; A-680-681) (emphasis added) Indeed, O'Brien of the Commission's Washington staff testified that he was aware that Ms. Chan had told Lloyd Carr that it had met the Commission's financial and record keeping requirements. (Tr. 153; A-337)

On Monday morning, January 24, 1977, in accordance with Ms. Chan's suggestion, Carr telephoned the Commission's New York office and spoke to James McCarthy, head of the Eastern Regional Office of Audit and Review. McCarthy stated that he could not approve the Lloyd Carr application and would have to send it on to his superior, O'Brien, in Washington. McCarthy stated that O'Brien would have Lloyd Carr's file by Tuesday, January 25, 1977. (Tr. 652-653; A-885-886)

McCarthy confirmed that Ms. Chan had reported to him that Lloyd Carr met the Commission's minimum financial requirements for registration as an FCM. (Tr. 678-679; A-861-862) However, he and O'Brien had determined, apparently because of some confusion resulting from the use of the name "Lloyd Carr & Co." on certain Lloyd Carr accounts and "Lloyd Carr Financial Co." on others, that Lloyd Carr should consolidate all its accounts under the name of "Lloyd, Carr & Co." (Tr. 695; A-878) As McCarthy testified:

" . . . Lloyd, Carr and Co. had had a predecessor firm by the name of Lloyd, Carr Financial Co., and it was just a matter of changing the name to Lloyd, Carr and Co. from Lloyd, Carr Financial Co." (Tr. 677; A-860)

As a result of McCarthy's suggestion, the identical FCM application was resubmitted to the Commission's New York office on January 25, 1977 with only the name of Lloyd Carr & Co. substituted for Lloyd Carr Financial Co. (DX 26(t)-(v); A-1046-1048)

On Tuesday morning, January 25, 1977, Carr spoke with O'Brien in Washington. (Tr. 653; A-836) O'Brien said that the Commission still was not satisfied with Lloyd Carr's application and that the Commission desired a variety of changes in names on bank accounts. These changes were made in a matter of hours. (Tr. 654; A-837) By Wednesday morning, January 26, 1977, Carr was apprised that O'Brien

had confirmed that all the changes requested by the Commission had been made. (Id.)

F. Division of Enforcement Intervention

At 11:30 on Wednesday morning, January 26, 1977, Carr again called O'Brien, who now advised him that the Commission wanted to return to Lloyd Carr's Boston office to perform a second audit, this time with personnel from the Commission's Division of Enforcement. (Tr. 655; A-838) The record discloses that O'Brien was satisfied with Lloyd Carr's application but stated that he was unable to grant approval for reasons he would not disclose. (Id.)

Understandably frustrated by this unexpected turn of events, Carr proposed a conference call between his then counsel Charles Hecht ("Hecht") and Commission personnel.

At 3:30 that afternoon Attorneys Stewart and Levie of the Commission's Division of Enforcement and O'Brien, spoke with Carr in Boston, and Hecht, in New York. (Tr. 656-657; A-839-840) In response to Stewart's request for a second audit, Hecht stated that he would agree to have the auditors come in again, but that he did not understand the reason for the presence of the Division of Enforcement. (Tr. 657; A-840) Stewart stated only that the Commission's auditors had been satisfied with their examination and would have registered Lloyd Carr but for

the fact that the Division of Enforcement had instructed O'Brien not to do so. (Tr. 657; A-840) Stewart then indicated that he would not permit Lloyd Carr's registration to proceed if Enforcement personnel were not permitted to examine Lloyd Carr's records in Boston the next day. (Tr. 658; A-841)

At no time did Stewart advise Carr or Hecht of a reason for the second audit. Indeed, the Administrative Law Judge stated that:

[T]he basis for this interest [in performing a second audit] is not readily apparent from the record, nor was it communicated to [Petitioners] (Rec. Dec.* 9; A-82)**

Hecht expressed his concern, based on prior experience, that Enforcement personnel would contact Lloyd Carr's customers and encourage them not to do business with

* The citation "Rec. Dec." refers to the Recommended Decision of the Administrative Law Judge, which appears at A-74 et seq.

** The Commission, after the fact, attempts to claim that the purpose of the second audit was to "verify that all regulatory criteria had been met." (Opinion at 16, A-140) Yet, at the hearing below, the Commission's counsel stated that the real reason that the Commission wanted to see Lloyd Carr's books and records -- which it had by that time subpoenaed in connection with the hearing -- was to establish that Lloyd Carr had been doing business after January 17, 1977 (Tr. 15-16; A-199-200), a fact that was not in dispute.

the firm.* He offered, however, to permit the second audit to go forward with Enforcement Division personnel present, provided Stewart would enter into a formal undertaking not to contact customers. (Tr. 660; A-843) Stewart refused and Hecht proposed other solutions, all of which were rejected by the Commission. (Tr. 659, 661; A-842, 844)

G. The Commission's Administrative Action

On February 3, 1977, the Commission commenced an administrative proceeding against Petitioners on the grounds that Petitioners had allegedly violated the federal commodities laws and the Commission's rules by, among other things, (i) continuing to do business after

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- * The record suggests that Hecht's concerns were not unfounded. (A-118-124) Indeed, the Administrative Law Judge noted:

"It may well be that [Petitioners'] morbid distrust of any action by this agency . . . has some foundation in fact. According to the un rebutted testimony of James A. Carr, a Commission employee contacted the United States Trust Co., Boston, Massachusetts [sic], and caused the bank to discontinue doing business with [Petitioners]. At that time [Petitioners] had on deposit with the bank an amount in excess of \$140,000.00." (Rec. Dec. at 23; A-96)

Nor is this an isolated case of the CFTC overstepping its bounds of authority. Other aspersions cast upon Lloyd Carr and certain of its associated persons are the subject of pending actions, for example, Lloyd, Carr & Co. v. CFTC, No. 77-C-3434 (N.D. Ill. 1977); Lucas v. CFTC, No. 77-0945C (E.D. Mo. 1977).

January 17, 1977 (ii) failing to keep current proper books and records and (iii) refusing to permit a second audit of the books and records. The sanctions sought in the administrative proceeding included denial of Lloyd Carr's application for registration as an FCM and revocation of its CTA license, imposition of civil monetary penalties of \$100,000 for each violation against each of the four respondents (i.e. Lloyd Carr, Financial and Carr and LeMieux personally), a cease and desist order requiring Petitioners to stop doing business and a prohibition against Petitioners' trading on or subject to the rules of any commodity contract market. (A-2 et seq.)

On February 8, 1977, the Commission moved in the United States District Court for the District of Massachusetts to temporarily restrain Lloyd Carr from doing business on the same grounds set forth in the Commission's Administrative Complaint. (CFTC v. James A Carr, et al., Civ. No. 77-371T.) The Court denied the Commission's motion and found that to require Petitioners to go out of business, particularly where there had been no allegation of fraud or harm to the public, would have been unduly harsh, especially since no hearing had yet been held with respect to Lloyd Carr's fitness to be licensed as an FCM.

(i) The Commission's Expedited Hearing Directive

On February 17, 1977 the Division of Enforcement moved the Commission for the adoption of "expedited procedures" in connection with the hearing on the Commission's February 3 administrative complaint against Petitioners.

(A-10) Although the Commission's complaint did not allege fraud, manipulation or breach of fiduciary responsibility, or any other sort of harm to the general public, the Division of Enforcement nonetheless claimed that an expedited hearing was necessary stating:

"A prompt hearing and decision on the allegations in the complaint will place in equipoise the rights of the [Petitioners] and the rights of the investing public." (A-14)

(1) The Commission's March 2, 1977 Order

Despite Petitioners' opposition, the Commission adopted expedited procedures. In an Order dated March 2, 1977, the Commission directed that: (1) the administrative hearing commence on March 8, 1977, just four business days later, and "continue without interruption until completed," (2) the Administrative Law Judge, immediately upon completion of the hearing, certify and transmit to the the Commission for decision the entire record of the proceeding, and (3) the parties file proposed findings of fact, conclusions of law and briefs in support thereof

three days after the conclusion of the hearings.*

(A-31)

2. Petitioners' Application
to Modify the March 2 Order

On the morning of March 4, 1977 Petitioners' counsel, who had never been consulted with respect to the scheduling of the hearing,** made an urgent telegraphic request to the Commission for "rescission or a stay" of its expedited hearing order. Counsel noted that he was engaged in this Court on March 8 in an appeal involving the Commission, that he was engaged on March 10 in another action involving the Commission and that he had an argument in the New York Supreme Court, Appellate Division, First Department on the same date. He added that he had firm

* Under the Commission's Rules of Practice the Division of Enforcement normally submits its proposed findings of fact, conclusions of law and briefs within 45 days of the close of the hearing, and respondents have 30 days thereafter to respond. (17 C.F.R. § 10.82 (1977)) The Administrative Law Judge is normally given 30 days after submission of papers to prepare an initial decision, which becomes final 30 days later unless modified by the Commission. (17 C.F.R. § 10.84 (1977))

** The hearing schedule was summarily established by the Commission with no consideration for the "convenience and necessity" of Petitioners and their counsel, as required by 17 C.F.R. § 10.61 (1977). Even Petitioners' time to respond to the Division of Enforcement's motion for adoption of expedited procedures was shortened from the ten days normally provided (17 C.F.R. § 10.26(b) (1977)) to five. (A-19)

"court commitments on March 11, 15, 16 and 21-25," and stated that "certain key witnesses for respondent cannot be contacted on such short notice and this is clearly insufficient time to prepare for a fully litigated proceeding." (A-38)

On the afternoon of March 4, Petitioners' motion opposing the expedited hearing order was denied, except that the Commission ordered the hearing to commence on March 9 instead of March 8, 1977. (A-40)

(ii) The Hearing and Its Abrupt Termination

The Commission's hearing commenced in Boston on March 9, 1977. The Commission put in its case over the course of six days, concluding (with the exception of one witness) in mid-day on March 17, 1977. (Tr. 26-672; A-210-855) Petitioners thereupon commenced their defense, calling as their first witness a Commission employee. (Tr. 674; A-857)

At the close of the hearing on March 17, the Administrative Law Judge ordered that the hearing be transferred from Boston to Washington D. C. and resume on March 21, 1977. (Tr. 702; A-885) Petitioners' counsel had previously objected to the change in venue (Tr. 270; A-454) and continued this objection, urging that Washington was an inconvenient location for Petitioners' witnesses.

(Tr. 726, 737; A-908, 920)*

On March 21, 1977, the hearing resumed in Washington. No testimony was taken that day, due to the unavailability of LeMieux, whom the Commission sought to call as its witness. The Commission's counsel announced that, except for LeMieux, he had no further witnesses. (Tr. 717; A-899) Petitioners' then counsel stated that he would be prepared to go forward with his witnesses the following day. (Tr. 726; A-908) He also made a motion for a directed verdict, which was denied. (Tr. 717-718; A-899-900)

* The Commission's claim that Petitioners did not object to the change in venue is plainly wrong. The record is clear that at the very first mention of a transfer to Washington, Petitioner's then counsel objected. (Tr. 270; A-454) This objection was later repeated. (Tr. 726; A-908) Moreover, the Commission's summary change of venue was contrary to an express representation by the Commission's counsel, before Judge Tauro of the United States District Court for the District of Massachusetts, that "Boston is the correct venue for this . . . Administrative case." This statement was made during a hearing in an action captioned James A. Carr v. CFTC, (Civ. No. 77-666T, D. Mass.), which action was instituted prior to the commencement of the Commission's administrative hearing and sought to enjoin the holding of the hearing pending a decision by this Court on the validity of the Commission's new regulations in British American Commodity Options Corp. v. Bagley, supra. The District Court did not enjoin the hearing. However, it is clear from the record that the court was made to understand that the entire hearing would be conducted in Boston. Relevant pages of the transcript of the hearing in that matter are annexed hereto as Addendum A for this Court's review.

On March 22, 1977, Petitioners began the presentation of their witnesses, and testimony was taken until 3:00 p.m. when Petitioners' last available witness was excused. (Tr. 817; A-1000) Thereupon, counsel for Petitioners stated that he had three more important witnesses to complete his case (Tr. 812-813; A-995-996), and that they would be available on the next day (Tr. 815; A-998). Petitioners' counsel noted that due to adverse rulings as to relevancy, the testimony of Petitioners' witnesses that day had been unexpectedly shortened. Since Petitioners' remaining witnesses were in Boston and Greenwich, they were not immediately available. (Tr. 813-814; A-996-997)

The Administrative Law Judge stated that "I would like to wind this hearing down and be finished with it" (Tr. 814; A-997), and ordered that the hearing resume at 8:30 a.m. on March 23 (Tr. 815; A-998). He further said:

"I will be here and if there is no one else here I will close the lid on the hearing and send the transcript to the Commission." (Tr. 815; A-998)

Petitioners' counsel objected to the 8:30 a.m. starting time noting that his witnesses were coming from Boston, New York City and Greenwich, Conn. The Administrative Law Judge overruled his objection. (Tr. 816; A-999)

In accordance with the Administrative Law Judge's direction, the hearing reconvened at precisely 8:30 a.m. on March 23, 1977. (Tr. 818; A-1001) Petitioners' counsel

noted that Irwin Winsten, Lloyd Carr's accountant and its first witness of the day, had taken the 7:00 a.m. flight from New York to Washington, but apparently had been delayed due to a heavy snow storm. (Tr. 819; A-1002) He further explained that Carr, his second witness, had been forced by the same storm to drive from Boston to New York in order to catch a flight to Washington to testify. (Id.)* Despite this explanation, the Administrative Law Judge stated:

"In view of the ruling yesterday I hereby order the hearing officially closed at this time."
(Tr. 819; A-1002)

The time was 8:32 a.m. (Id.) One minute later, at 8:33 a.m., Winsten arrived. (A-112) Although the Administrative Law Judge was immediately requested to continue the hearing (id.), he adamantly refused. Petitioners were precluded from giving any further evidence in this matter.

Had Winsten been permitted to take the stand, he would have testified concerning all financial aspects of Lloyd Carr's operations, including the nature of Lloyd

* Messrs. Winsten and Carr filed affidavits with the Commission attesting to these facts. They were included in the record and appear at A-110-116. The third witness was Mr. Labus, a resident of Greenwich, Connecticut. (Tr. 814; A-997)

Carr's books and records as of January 17, 1977 and thereafter. His testimony would have demonstrated that Lloyd Carr was in complete compliance with all the rules and regulations of the Commission respecting commodities options dealers. Significantly, the Commission's own counsel stated that such evidence was important with respect to the sanction to be imposed in this case, if any, and stated that its exclusion would be "reversible error." (Tr. 569; A-752)

In addition, Carr, who was en route to Washington (A-113 et seq.) and would have arrived in ample time to immediately follow Winsten on the witness stand, would have offered additional testimony as to the nature of Lloyd Carr's operations on and after January 17, 1977, the reasons Lloyd Carr had continued to do business after that date, and the harm to Lloyd Carr and the public that would result from denial of a license. Most importantly, he had with him photostatic copies of Lloyd Carr's complete books and records (A-115), which would have demonstrated that they were and are in full compliance with all of the Commission's record keeping requirements.

Petitioners submit that the refusal to reopen the hearing after a lapse of at most one minute deprived the Petitioners of due process of law and was arbitrary and unreasonable in the extreme. Had Petitioners been

permitted to complete their case, they would have clearly demonstrated that Lloyd Carr was entitled to be licensed as an FCM and that the Commission should not impose the ultimate sanction of depriving them of the right to do business.

(iii) The Administrative Law
Judge's Post-Hearing Notice

On the day following the closing of the hearing, the Administrative Law Judge entered a "Notice" dated March 24 stating that his decision would include "a specific inferential finding of fact that on March 17, 1977, respondents' books and records were not being maintained in accordance with the law and regulations." (A-69-70)* The Notice

* On the third day of the hearing, apparently in an attempt to short-cut questions arising out of the manner of Petitioners' compliance with the Commission's document subpoena, as modified by stipulation of the parties (Tr. 15-16; A-199-200), the Administrative Law Judge summarily ordered that Lloyd Carr permit a Commission auditor to conduct a complete audit of all of its books and records at Lloyd Carr's office -- while the hearing continued and despite the fact that Petitioners had produced extensive books and records in compliance with the Commission's subpoena -- provided only that the Commission not be permitted to contact any customers whose identities might be learned during the course of the audit. (Tr. 253-260; A-437-444) Although the terms of this order were not acceptable to either party at the time, Petitioners' counsel subsequently agreed to permit such an audit. (Tr. 633, 720; A-816, 902) Nonetheless, the Administrative Law Judge held Petitioners initial reluctance to permit the audit against them, stating at one point that he "wished" that Petitioners had acquiesced in his ruling while the hearing was in Boston, since, if they had, he might have granted their motion for a directed verdict. (Tr. 719-720, 730; A-901-902, 911)

further provided that Lloyd Carr could, within the next five days (i.e., by March 29), have their books and records audited by either a Commission auditor or "an independent CPA firm" selected by the Administrative Law Judge from a list of ten such firms provided by Petitioners. The Notice concluded:

"Should this audit not be conducted, then the Administrative Law Judge . . . will have little choice but to find that the books and records are not in order at this time."
(A-70)

Although the Administrative Law Judge's Recommended Decision states that the terms of the Notice were telephonically communicated to Petitioners' counsel on the date of the Notice (Rec. Dec. at 27-28; A-100-101), Petitioners' counsel claimed not to have received the Notice until the afternoon of March 28, 1977, one day before the March 29, 1977 deadline (A-71). Had the Administrative Law Judge not closed the hearing, all of Lloyd Carr's books would have been made a part of the record and would have been available to the Commission for whatever purposes it might desire including an audit.

H. The Administrative Law Judge's
Recommended Decision

The Administrative Law Judge filed his Recommended Decision on April 12, 1977. In it he adopted nearly all of

the Division of Enforcement's proposed findings of fact and conclusions of law, which he argued was warranted by the refusal of Petitioners to accept the offer set forth in his March 24 Notice. (Rec. Dec. at 30; A-103) However, the Administrative Law Judge stated that his Recommended Decision "would be considerably different in result had [Petitioners] permitted an audit of their books and records during or after the hearing." (Rec. Dec. at 29; A-102) As noted, Petitioners did agree to permit such an audit (Tr. 633, 720; A-816, 902), and would have introduced into evidence their books and records had the hearing not been peremptorily ended in the midst of their case.

The Administrative Law Judge also stated that, because no charges of fraud or misdealing had been made, "it appeared that the issues in this case could have been settled on terms other than putting [Petitioners'] operation out of business," a result which he found "would cause great hardship for a number of people." (Rec. Dec. at 26; A-99) Nonetheless, he later concluded that Lloyd Carr's "conduct during and after the trial" warranted an inference that Lloyd Carr's books and records were not in compliance with the Commission's rules and regulations. (Rec. Dec. at 30; A-103) He added that "[e]ven though not charged in the Commission's Complaint, this inference casts an aura of

fraud over the entire operation of [Petitioners'] business."
(Id.)

The Administrative Law Judge recommended that:
(i) Lloyd Carr's application for registration as an FCM be denied, (ii) the CTA registration of Lloyd Carr, issued in the name of Financial, be revoked, (iii) LeMieux' registration as an "associated person" be revoked, (iv) Petitioners be ordered to cease and desist from violating the Commodity Exchange Act, (v) respondents be prohibited from trading on or subject to the rules of any contract markets and that such contract markets be ordered to refuse all trading privileges to Petitioners, (vi) Carr and LeMieux be assessed civil penalties of \$10,000 each, and (vii) Lloyd Carr be assessed a civil penalty of \$100,000. (Rec. Dec. at 33-34; A-106-107)

I. The Commission's Opinion

Despite its earlier finding that speed was needed in this matter to "protect the public," the Commission delayed for nearly four months after the filing of the Administrative Law Judge's Recommended Decision, before it issued its August 1, 1977 Opinion and Final Order. This destroyed any "equipoise" between the public interest and Petitioners' rights that the Division of Enforcement claimed would be preserved by expedition. (See p. 18 supra)

In its Opinion, the Commission found Petitioners to have been guilty of all the violations of the statutes and charged. Its final order denied Lloyd Carr's application for registration as an FCM, revoked Lloyd Carr's CTA license, and ordered that Petitioners cease and desist from the violations of the Commodities Exchanges Act and the Commission's regulations with which they were charged. (A-181-182)*

The Commission in its opinion expressly stated that it had based its sanctions only upon (i) the continuance of Lloyd Carr's business after January 17, 1977 without registration as an FCM and without registration of a number of its salespersons as "associated persons,"** and (ii)

* The Administrative Law Judge's recommendation that monetary sanctions be imposed was rejected by the Commission. (Opinion at 54; A-178)

** The record is clear that 38 Lloyd Carr salespersons who had not previously been registered as associated persons all filed their registration applications on January 20, 1977. (Opinion at 16; A-140) The applications were processed and approved by the Commission in early March, 1977. (Tr. 791-792; A-974-975) Significantly, the Commission announced, in its release published on January 19, 1977 (42 Fed. Reg. 3699 (1977)) that as of January 17, 1977, it had been unable to process approximately 500 associated person applications, the "vast majority" of which had been filed during the week just prior to the January 17 registration deadline. (*Id.* at 3700) We submit that, for the reasons set forth in this brief, the alleged "associated persons" violation is not a sufficient ground upon which to base a denial of Petitioners' right to earn a livelihood.

Petitioners' alleged failure to permit a second audit of Lloyd Carr's books and records. The Commission expressly stated:

"[W]e do not base the imposition of any sanction upon the violations we find relating to the condition of respondents' books and records, since those violations were not, at least at the outset, the result of deliberate decisions calculated to defy the Commission's authority." (Opinion at 51; A-175)

The Commission noted that its complaint had not questioned Petitioners' "fair dealing or training program," on which it admittedly placed "high value . . . in certain circumstances." (Opinion at 52; A-176) Moreover, the Commission expressly rejected any finding or even inference of "fraud, manipulation or breach of fiduciary responsibility." (Opinion at 55; A-179) Finally, the Commission found that:

"[T]here is no evidence in the record to establish that [Petitioners'] activities were conducted on, related to or had any adverse impact on any contract market." (Opinion at 56; A-180)

Nonetheless, the Commission sought to justify the severity of the sanctions it imposed by characterizing Petitioners' decision not to abandon their livelihood while their registration application was pending as a "callous disregard for the law." (Opinion at 53; A-177)* The Commission

* As noted at p. 17, supra, the United States District Court for the District of Massachusetts, on February 8, 1977, had found Petitioners' decision to remain in business to be anything but improper. Balancing the hardship upon Petitioners which would have resulted from ordering them to cease doing business, against the Commission's utter failure -- as it has failed here -- to make any claim of fraud or misdealing, the court found that Petitioners were entitled to remain in business at least until the Commission had determined, after a hearing whether to grant them a license.

stated that annihilation of Petitioners' means of earning a livelihood was necessary in order to demonstrate the "principle" that "the Commission cannot -- and will not -- permit persons to deliberately flout the law with impunity." (Id.) The Commission's Opinion makes it abundantly clear that the true purpose of the sanctions imposed upon Petitioners was to single them out, as an "example" to the industry. Thus, the Commission stated:

"The Commission has received a mandate from Congress to establish order in and control over an industry unused to the feel of stringent government regulation. In this context, and at this stage of its existence, the Commission must make its expectations known to all and to assert its authority when called for, lest it invite defiance from those subject to its regulations." (Opinion at 53; A-177)

For the reasons set forth below, Petitioners submit that they are an inappropriate whipping boy in this case.

ARGUMENT

I

PETITIONERS HAVE BEEN DENIED DUE PROCESS OF LAW

In its opinion below, the Commission admitted that:

"The hearing was terminated before [Petitioners] had completed their case." (Opinion at 6 n.7; A-130)

It is well settled that this procedural defect, standing alone, is of such magnitude as to warrant vacation of the Commission's final order.

In Blackwell College of Business v. Attorney General, 454 F.2d 928 (D.C. Cir. 1971), the District of Columbia Circuit -- "a court of special importance for administrative law," Friendly, "Some Kind of Hearing," 123 U. Pa. L. Rev. 1267, 1310 (1975) -- held that the Immigration and Naturalization Service had improperly withdrawn a college's status as an approved school for nonimmigrant alien students without having granted the college a prior hearing. The college admitted that it had failed to comply with certain reporting requirements necessary for agency approval, but the court, nonetheless, held the agency action improper, stating:

"The record contains evidence that appellant failed to comply with its reporting obligations. To affirm for this reason, however, would overlook substantial procedural defects in the manner in which the record was compiled. It would also overlook the possibility that had appropriate procedures been followed, action less drastic than total withdrawal of approval by the District Director might have resulted. The wide latitude and discretion inevitably given to executive officials and administrative agencies in regard to enforcement policy puts upon them a corresponding obligation to institute and abide by procedures that give affected persons a meaningful opportunity, before adverse decisions are crystallized, to make appeal to their discretion." 454 F.2d at 931-32 (emphasis added).

Similarly, in Russell-Newman Mfg. Co. v. NLRB, 370 F.2d 980 (5th Cir. 1966), the petitioner, who had been given little prior notice of the unfair labor practice

charges against him, sought a postponement of the hearing. The postponement was denied, but the trial examiner permitted the petitioner to make an offer of proof (an opportunity not accorded Petitioners before the record below was summarily closed). The court reversed the agency action, stating:

"Due process in an administrative hearing includes a fair trial, conducted in accordance with fundamental principles of fair play and applicable procedural standards established by law. Administrative convenience or necessity cannot override this requirement, Swift and Co. v. United States, 7 Cir., 1962, 308 F.2d 849; Hornsby v. Allen, 5 Cir., 1964, 326 F.2d 605.

"The refusal of the Trial Examiner to receive and consider competent and material evidence which could have been offered after a reasonable opportunity to meet the charges amounts to denial of due process, and the fact that the Board had reached, or might have reached, no different conclusion had the rejected evidence been received is entirely beside the point, N.L.R.B. v. Burns, 8 Cir., 1953, 207 F.2d 434." 370 F.2d at 984 (emphasis added).

See also Great Lakes Screw Corp. v. NLRB, 409 F.2d 375, 381 (7th Cir. 1969); NLRB v. Bryan Mfg. Co., 196 F.2d 477, 478 (7th Cir. 1952); Donnelly Garment Co. v. NLRB, 123 F.2d 215 (8th Cir. 1941).

As this Court itself has recently stated:

"The fairness of the 'hearing' depends not only upon the opportunity to answer the facts so adduced, but also to present the adversary's own factual version." RCA Global Communications, Inc. v. FCC, No. 76-4054, Slip. Op. at 4977 (2d Cir. July 27, 1977).

Here, the precluded testimony was that of Lloyd Carr's accountant (Winsten) (A-110-112), its principal (Carr) (A-113-116) and the manager of one of its offices (Labus). Their testimony would have conclusively shown that Lloyd Carr met the Commission's licensing requirements on January 17, 1977 and that its books and records were in compliance with the applicable rules and regulations. Indeed, the very books and records that had been such a source of concern to the Administrative Law Judge would have been introduced into evidence in their entirety had the hearing not been closed, and would have made the Administrative Law Judge's March 24, 1977 Notice unnecessary. The Commission's own counsel conceded that to refuse to admit evidence such as that excluded by the summary termination of the hearing would be "reversible error." (Tr. 569-570; A-752-753)

The Commission, in an attempt to escape from the inevitable consequences of the summary termination of the hearing below, adopted the Administrative Law Judge's feeble excuses for prematurely closing the record. (Opinion at 6 n.7; A-130) The Administrative Law Judge attempted to justify his impulsive termination of the hearing by stating:

"Solely to accommodate respondents, or counsel for respondents, this hearing opened on March 9 rather than March 8; the hearing was recessed on March 10 and 11 to permit respondents' counsel to tend to other legal chores; the hearing

was reconvened on March 15 rather than March 14 to permit respondent Carr and respondent's counsel an opportunity to attend a hearing in Canada; the hearing on March 21 ended at 10:50 due to the failure of LeMieux to appear as a witness; the hearing recessed early on March 22 due to failure of respondents to have witnesses available; the hearing was terminated at 8:32 a.m. on March 23 due to respondents refusal to comply with a direct, specific order to have witnesses available at 8:30 a.m. to begin testimony [citations omitted]." (Rec. Dec. at 13-14; A-86-87)

This explanation is wholly misleading. The start of the hearing was delayed one day by order of the Commission to permit Petitioners' counsel to appear in this Court in a related case involving the Commission. (A-40) The adjournment on March 11 and the one-day recess on March 14 were by stipulation of counsel, approved by the Commission. (A-42) The early recess on March 22nd was due to the fact that the Administrative Law Judge excluded much of the evidence offered by Lloyd Carr's witnesses, thus unexpectedly shortening that day's proceedings. (Tr. 813-814; A-996-997) Finally the hearing was closed at 8:32 a.m. on the morning of March 23, just one minute before Petitioners' first witness, who, delayed by a storm, was ready to testify. (A-112)*

* These last two difficulties would have been avoided had the hearings remained in Boston rather than being abruptly removed to Washington over Petitioners' objection and contrary to the Commission's representation that Boston was the proper venue. See note at p. 21, supra.

These scheduling problems would no doubt have been avoided had the Commission simply followed its own rule requiring that the time and place of the hearing be fixed with "due regard" for "the convenience and necessity of the parties and their representatives." (17 C.F.R. § 10.61(c)(1977)) Surely, under the circumstances, and regardless of how Petitioners' counsel's conduct is characterized, it did not justify denying Petitioners the opportunity to complete their case.

The Commission's suggestion (Opinion at 42, A-166) that the expedited nature of the hearing below justifies depriving the Petitioners of due process is equally untenable. As the Supreme Court stated long ago:

"There can be no compromise on the footing of convenience or expediency, or because of a natural desire to be rid of harassing delay, when that minimal requirement [of a fair hearing] has been neglected or ignored." Ohio Bell Tel. Co. v. Public Util. Comm'n, 301 U.S. 292, 305 (1937).

The District of Columbia Circuit has affirmed this principle, stating:

"Administrative procedures fail of their fundamental purpose if the goal of expedition is bought at the sacrifice of reasoned decision-making and substantial fairness to the parties concerned." Municipal Elec. Util. Ass'n v. FPC, 485 F.2d 967, 973 (D.C. Cir. 1973).

Recognizing that the abrupt termination of the hearing cannot be justified by either the conduct of

Petitioners' then counsel or the expedited nature of the proceedings, the Commission has attempted to characterize the premature closing of the record as nothing more than a "denial of a continuance," to which the "abuse of discretion" standard of review applies. (Opinion at 42 n.45; A-166 n.45) This is absurd. The Commission's action clearly operated to close the record entirely, thereby preventing Petitioners from presenting evidence critical to their case. To characterize this as a mere "denial of a request for continuance" is a cynical and duplicitous distortion of the truth.

The Administrative Law Judge's belated attempt to remedy his error, by means of his March 24 Notice (A-69), was clearly inadequate. His allowance of five days -- from Thursday, March 24 to Tuesday, March 29 -- to conduct a complete audit of all of Lloyd Carr's books and records was clearly insufficient. But for his precipitous closing of the hearing, this procedure would have been unnecessary. Surely due process requires that a party be permitted to put in its own case in the manner it deems most advantageous.

As the Supreme Court has long recognized:

"The maintenance of proper standards on the part of administrative agencies in the performance of their quasi-judicial functions is of the highest importance and in no way cripples or embarrasses the exercise of their appropriate authority. On the contrary, it is in their manifest interest.

For, as we said at the outset, if these multiplying agencies deemed to be necessary in our complex society are to serve the purposes for which they are created and endowed with vast powers, they must accredit themselves by acting in accordance with the cherished judicial tradition embodying the basic concepts of fair play." Morgan v. United States, 304 U.S. 1, 22 (1938).

The summary termination of the hearing below was manifestly not in accordance with "basic concepts of fair play." Accordingly, the Commission's final order cannot stand.

II

LLOYD CARR MET THE REQUIREMENTS FOR REGISTRATION
AS A FUTURES COMMISSION MERCHANT ON JANUARY 17,
1977 AND PROPERLY CONTINUED TO DO BUSINESS

In its published release of January 19, 1977, the Commission set forth the standards it had applied to commodity options dealers who had applied for registration as FCM's pursuant to the licensing requirement that had become effective two days before. The Commission stated:

"Letters advising FCM applicants that Registration has been granted were sent to those applicants who satisfied the fitness requirements and met the minimum adjusted working capital requirement of regulation 1.17(b)(1)." 42 Fed. Reg. 3699, 3701 (1977).

The record is clear that Lloyd Carr met these two requirements on January 17, 1977. After a two day audit of Lloyd Carr's books and records, the Commission's auditors

concluded that Lloyd Carr met, by nearly two-fold, the minimum adjusted working capital requirements. (Tr. 421; A-604. See also Tr. 484; A-668)) So clear was this fact that, at the hearing below, counsel for the Commission conceded that:

"...[Lloyd Carr] is not in any way charged with failing to meet the minimum financial requirements" (Tr. 447; A-631) (emphasis added)

There can also be no question but that Lloyd Carr and its principals met the fitness requirements for licensing as an FCM on January 17, 1977. Indeed, the Commission nowhere attempts to dispute this fact. The fitness standards for registration as an FCM are outlined in Section 8a of the Commodity Exchange Act, 7 U.S.C. § 12a (Supp. IV 1974). This provision permits the Commission, in its discretion, to deny registration to (i) persons whose FCM registration had previously been suspended or revoked; (ii) persons determined, after an opportunity for a hearing, to be unfit by reason of having engaged in a practice "of the character prohibited" by the Commodity Exchange Act, having been convicted of a felony, having been debarred by any agency from contracting with the United States, having made false or misleading statements or having omitted to state any material fact in connection with their FCM application,

or "for other good cause shown;"* and (iii) persons found after an opportunity for a hearing to have failed to meet the minimum financial requirements.

In the present case, the denial of registration and other sanctions imposed by the Commission were based on its conclusion that Petitioners had engaged in practices "of the character prohibited by" the Commodity Exchange Act. (Opinion at 45 et seq.; A-169 et seq.) Reduced to its essentials, however, the allegedly proscribed conduct was Petitioners' continuance in business after January 17, 1977, knowing that they were required to be registered. (See Opinion at 51; A-175)** No substantive basis was

* Recognizing that the "other good cause shown" category was "not specific and need[ed] Commission interpretation," the Commission, in a public release published on July 3, 1975 (40 Fed. Reg. 28,125, at 28,126 (1975)), stated that it would interpret "good cause" to include, among other things, (i) operations disruptive of orderly commodity markets, (ii) felony or misdemeanor convictions involving commodities or securities, or injunctions, consent decrees or settlements to which the Commission or the Securities and Exchange Commission is a party, and (iii) willful violations of the Commodity Exchange Act within the past ten years. However, the Commission reserved the right to grant a license to an applicant "even though that person has committed an act listed in this interpretation." (Id.)

** The Commission also purports to base its denial of a license on what it claimed to be Petitioners' willful refusal to permit a second audit of Lloyd Carr's books and records by Commission auditors and personnel from the Division of Enforcement. This ignores the facts that (i) the Commission was able to determine on the

(Footnote continued)

found for the finding that Petitioners were "unfit"; indeed, the Commission's own witness admitted that, as of November 19, 1976, the Commission had found Petitioners fit to be licensed as a CTA under standards identical to the fitness standards for FCM's.* (Tr. 524, 533; A-707, 716)

The decision of Petitioners not to abandon their source of livelihood on January 17 was not malicious, as the Commission's opinion seeks to imply. The record clearly shows that, far from attempting to evade or avoid the

(Footnote continued)

basis of its first two day audit and its aftermath that Lloyd Carr was qualified to be registered as an FCM (Tr. 655, A-838); (ii) no reason was communicated to Petitioners as to why the second audit was needed (Rec. Dec. at 9; A-82); (iii) the true purpose of the second examination of Lloyd Carr's books and records appears to have been merely to determine that Lloyd Carr did business after January 17, 1977 (Tr. 15-16, A-199-200), a fact Petitioners do not dispute; and (iv) Petitioners did in fact offer to permit the second audit provided only that Division of Enforcement personnel were not present or would agree not to engage in certain conduct (Tr. 633, 657, 720, A-816, 840, 902).

- * The Commission attempts to make much of what it claims to be the inadequate state of Lloyd Carr's books and records. But it deliberately failed to follow its customary practice of sending a deficiency notice and permitting an opportunity to remedy the alleged defect. (Tr. 411, 690; A-594, 873) Under such circumstances, this court has held the imposition of a sanction to be improper. Economou v. United States Dep't of Agriculture, 494 F.2d 519 (2d Cir. 1974).

Commission's regulations, Petitioners sought continuously to comply with them and, in the words of one Commission witness, were cooperative with the Commission toward this end. (Tr. 164-165; A-349-350) (See pp. 45-46 infra)

In Arthur Lipper Corp. v. SEC, 547 F.2d 171, 184 (2d Cir. 1976) (Friendly, J.), this Court cited with approval the following observation in Schwartz & Wade, Legal Control of Government 270 (1972):

"One of the limitations of the administrative expert is his tendency to single-mindedness and excessive zeal.[*] The judges can stand apart from the tensions of the immediate case and mitigate the enthusiasm of the expert by the community's sense of justice."

Petitioners submit that Lloyd Carr met the substantive requirements for registration as an FCM on and after January 17 -- the first day on which they were required to be so registered. We also should note that Section 558 of the Administrative Procedure Act provides

[*] The Commission's Chairman was recently quoted as boasting that the Commission had accomplished more in its first two years than the Securities and Exchange Commission had accomplished in its first ten years, and has publicly advocated banning all options trading -- despite wide industry support therefor and the Commission's new rules permitting such activity -- as a ploy to induce Congress to appropriate additional funds so that the Commission can crack down on what the Chairman has described as "an inordinate number of fly-by-night hustlers" -- i.e., options salesmen. The Futures Regulator Comes Under Fire, Business Week, August 15, 1977, at 97, 98.

that when a timely and sufficient application for a renewal or a new license is made, a license with reference to an activity of a continuing nature does not expire until the application has been finally determined. In continuing to do business on and after January 17, 1977 while its application for an FCM license was pending, we respectfully submit that Petitioners were entitled to the protections of 5 U.S.C. § 558 (1970).

Petitioners originally submitted an application for an FCM license on October 1, 1976. Although that application was physically returned because of the absence of a financial statement form and certain biographical data, the Commission retained Petitioners' filing fee at the time. The Commission's regulation then and now provided that where an application for a license is refused, the Commission must return the applicant's fee. 17 C.F.R. § 1.13 In not doing so, we believe, the Commission effectively treated Petitioners' application of October 1 as a continuing one during the period between October 1, and January 17, 1977.

When Petitioners resubmitted their application on January 17, 1977, it was accompanied by the required financial information as well as the biographical data previously requested by the Commission. Consequently, Petitioners met the requirements for licensing as of that date. We submit

that until the Commission's action to deny registration is resolved, Petitioners are entitled to continue business and their actions in so doing cannot be considered by the Commission to be an "intentional and deliberate violation" of the act and a basis for denial of registration. See In re Petro, 8 and Ad. L.2d (P&F) 129, 131 (USDA. 1957) Accordingly, this Court should exercise its authority under 5 U.S.C. § 706(1) (1970) to vacate the Commission's order and direct the Commission to issue Lloyd Carr an FCM license.

III

THE COMMISSION'S CONCLUSION THAT
PETITIONERS WERE "FLOUTING THE
LAW" IS MANIFESTLY AGAINST
THE WEIGHT OF THE EVIDENCE.

In its Opinion below, the Commission stated that its determination to impose sanctions upon Petitioners was based only on two violations by them of the Commissions's rules: (i) continuing to do business after January 17, 1977, and (ii) allegedly refusing to permit a second audit by the Commission Staff. (Opinion at 51; A-175) Recognizing that these violations do not inherently warrant imposition of the ultimate sanction of depriving Petitioners of their right to earn a livelihood, the Commission attempted to justify the severe punishment it had selected by claiming

that Petitioners had "flout[ed]" and exhibited "callous disregard for" the law, and could not be permitted to do so "with impunity." (Opinion at 53; A-177) Petitioners submit that these findings are unwarranted and erroneous.

In its recent decision in Haltmier v. CFTC, 554 F.2d 556 (2d Cir. 1977), this Court articulated the standard which a reviewing court should apply to the Commission's factual findings:

"Unlike most other legislation providing for judicial review of agency decision, the Commodity Exchange Act (as carried forward by the Commodity Futures Trading Commission Act) declares that 'the findings of the Commission as to the facts, if supported by the weight of evidence shall * * * be conclusive.' 7 U.S.C. § 9. The 'weight of the evidence' means 'the preponderance' or 'greater weight of the evidence' . . . but the court's function 'is something other than that of mechanically reweighing the evidence to ascertain in which direction it preponderates; it is rather to review the record with the purpose of determining whether the finder of the fact was justified, i.e. acted reasonably, in concluding that the evidence, including the demeanor of the witnesses, the reasonable inferences drawn therefrom and other pertinent circumstances, supported his findings. . .'" 554 F.2d at 560 (emphasis added; citations omitted).*

* Recently, in Collins Sec. Corp. v. SEC, CCH Fed. Sec. L. Rep. ¶ 96,122 (D.C. Cir. 1977), the District of Columbia Circuit held that, where an agency sanction deprives a licensee of the right to pursue a livelihood, the licensee's conduct must be judged by the "clear and convincing evidence" standard, as opposed to the mere "preponderance of the evidence standard"

(Footnote continued)

Even the truncated hearing record produced in this case* clearly demonstrates that Petitioners not only did not "flout the law," but that, to the contrary, they made substantial attempts to comply with the law. Specifically, the record demonstrates that:

- 1) Petitioners promptly filed an application for a CTA license after going into business in about August 1976 (Tr. 524-525; A-707, 708);
- 2) Petitioners first filed for an FCM license on October 1, 1976 (Tr. 279, DX 9(a); A-463, 1007);
- 3) Petitioners fairly met all the Commission's FCM licensing standards on January 17, 1977, the day on which, pursuant to new regulations imposed for the first time on the young commodity options industry, Petitioners were required to be registered with the Commission as an FCM (see Point II supra);

(Footnote continued)

used by the Commission below and adopted in Haltmier, supra, (which involved only a suspension, as opposed to the denial, of a license). Petitioners submit that, in view of the sanctions imposed by the Commission here, their conduct should properly be measured by the higher standard. But, as demonstrated herein, even if the less stringent "preponderance" standard is employed, the record still does not warrant a finding that Petitioners "flouted" or exhibited "callous disregard for" the law.

- * We submit that, without affording Petitioners an opportunity to complete their case, the Commission was in no position to fairly conclude that Petitioners had "flout[ed] the law" or exhibited "callous disregard" therefor.

- 4) Petitioners' cooperated with the Commission in connection with the processing of their application (Tr. 164-165; A-347-348)
- 5) The Commission neither charged nor was able to show "fraud, manipulation or breach of fiduciary duty" -- and the full Commission expressly so held (Opinion at 55; A-179);
- 6) The Commission expressly found that Petitioners' conduct had no adverse impact on any commodity market. (Opinion at 56; A-180)
- 7) Petitioners adopted a comprehensive training and sales monitoring program for its sales force, so as to insure the implementation of high standards of conduct in their business, and have instituted procedures to insure that options are a suitable investment for all persons desiring to become customers (Tr. 38-40, 58, 81-82, 769-772, DX-7; A-222-224, 242, 265-266, 952-955, 1005);
- 8) Petitioners have established a special bank account in which to segregate customers' funds pending execution of option orders (Tr. 591; A-774); and
- 9) Petitioners have experienced only "one or two" customer complaints (Tr. 231; A-415), and the customer witness called by the Commission testified that Lloyd Carr had handled his complaint promptly and to his full satisfaction, that the Lloyd Carr personnel he had dealt with were competent and courteous, and that he desired to continue to do business with Lloyd Carr (Tr. 141, A-325).

These are clearly not the characteristics of one who has a

"callous disregard for the law".* Indeed, the Commission did not refute, or even attempt to dispute, the testimony in the record that on oral argument before this Court on January 17, 1977, the Commission's counsel took the position that as long as Petitioners met the minimum financial and fitness requirements, there would be "no problems" with Petitioners' application. (Tr. 750; A-933)**

While the Commission's Opinion makes much of Petitioners' alleged refusal to permit a "second audit" of their books and records, the record shows that Petitioners did not oppose a true "second audit," even though two Commission auditors, just a week before the request for the second audit, had concluded that Petitioners met by nearly two-fold the minimum capital requirements for registration.

* Petitioners urge this Court to contrast their conduct with that of the defendants in, for example, CFTC v. British American Commodity Option Corp., CCH Comm. Fut. L. Rep. ¶ 20,457 (2d Cir. 1977); CFTC v. Crown Colony Commodity Options, Ltd., 434 F. Supp. 911 (S.D.N.Y. 1977); and Silverman v. CFTC, CCH Comm. Fut. L. Rep. ¶ 20,487 (7th Cir. 1977). There, unlike the present case, the imposition of sanctions which effectively put a party out of business was based upon explicit findings of fraud. Indeed, Petitioners are aware of no case where this ultimate sanction was imposed absent such a finding. Yet that is precisely what the Commission seeks to do here.

** This was the first of several occasions on which the Commission led Petitioners to believe that they would be licensed promptly. (See Tr. 153, 306, 496-497; A-337, 490, 680-681)

(Tr. 421; A-604) Petitioners' counsel only objected to the Commission's request to send Enforcement Division personnel to review Petitioners' books and records. His reluctance was based on the fear that the Division of Enforcement would attempt to contact customers and adversely affect Petitioners' business. Indeed, the Division of Enforcement personnel have consistently refused to unequivocally represent that they would refrain from contacting customers if Petitioners' affairs were otherwise in order. (Tr. 254, 660; A-438, 843) Moreover, the Commission, which originally refused to say why the second audit was required, implicitly acknowledged that the true purpose for the second audit was to determine if Petitioners had done business after January 17, 1977, a fact which Petitioners did not dispute, and of which the Commission already had sufficient documentation.*

Viewed in this light, the Division of Enforcement's ultimatum that Petitioners' registration be condi-

* Significantly, when Petitioners obtained new counsel in early August, 1977, they immediately offered to permit the Commission to make a complete audit of their entire books and records for the whole thirteen month period that Petitioners had been in business. Over a period of seven days' two Commission auditors scoured Petitioners' books and records. Two months have since passed, yet the Commission has made no claim of fraud, manipulation or breach of fiduciary duty; indeed, it could not make such a change, since no such conduct has ever occurred.

tioned upon a second audit, coming as it did just a week after two Commission auditors had spent two days reviewing Petitioners' books and records and had rendered a complete report thereon, smacks of harassment. The Petitioners did, in fact, produce extensive business records in the course of the hearing (Tr. 260, 714, A-444, 896), and would have produced all their books and records had the hearing below not been abruptly terminated.

In sum, no dispassionate view of the abbreviated hearing record compiled in this case can support the Commission's conclusions that Petitioners "flouted the law" or exhibited "callous disregard" therefor. These findings, which are the linchpins of the Commission's harsh and vindictive determination to deprive Petitioners of a license to pursue their livelihood, are clearly contrary to the manifest weight of the evidence, and should not be permitted to stand.

IV

THE SANCTIONS IMPOSED BY THE COMMISSION
ARE SO UNDULY HARSH AS TO AMOUNT TO A
CLEAR ABUSE OF DISCRETION

By denying Petitioners' application for a license as an FCM and revoking Petitioners' license as a CTA, the Commission has imposed the ultimate sanction within its power. If these sanctions are permitted to stand, Lloyd

Carr will have to go out of business. Petitioners as well as their several hundred employees will lose their means to earn a livelihood, and investors doing business with Lloyd Carr would be forced to go elsewhere. This is an unduly harsh result, particularly since, as the Commission's Opinion notes, there was neither an allegation, nor any showing, of "fraud, manipulation or breach of fiduciary duty" in this case (Opinion at 55; A-179), and the Commission further found that the Petitioners' conduct had no adverse impact on any contract market (Opinion at 56; A-180).

As this Court recently reaffirmed, "Commission ordered penalties are reviewable as to severity" Arthur Lipper Corp. v. SEC, 547 F.2d 171, 183 (2d Cir. 1976). There, the revocation by the Securities and Exchange Commission of a broker-dealer's registration -- on grounds of actual fraud -- was vacated and a suspension of the license was imposed by this Court instead. In concluding that this Court had the power to review agency sanctions, Judge Friendly cited with approval (547 F.2d at 184) the view of Professor Jaffe that:

"It is not in accord with current concepts of justice that the exercise of such drastic powers [to revoke or suspend a license] should be totally beyond revision, particularly where exercised by our monolithic, policy-oriented agencies." Jaffe, Judicial Control of Administrative Action 270-271 (1965)

He also adopted the position of Professors Schwartz and Wade that:

"One of the limitations of the administrative expert is his tendency to single mindedness and excessive zeal. The judge can stand apart from the tensions of the immediate case and mitigate the enthusiasm of the expert by the community's sense of justice." Schwartz & Wade, Legal Control of Government 270 (1972)

Judge Friendly concluded that:

"[G]iven our power to review [agency] penalty determinations, our authority to limit such sanctions in appropriate cases seems necessarily to follow." 547 F.2d at 184

Similarly, in Beck v. SEC, 430 F.2d 673 (6th Cir. 1970), cited by this Court in Lipper, the Sixth Circuit set aside, as too harsh, a four month suspension by the SEC for certain illegal and fraudulent acts committed several years earlier. The Court concluded that the imposition of such a sanction was a gross abuse of discretion where the record disclosed "no reason to believe that [Beck] is inclined to commit any further illegal or fraudulent acts." 430 F.2d at 674.

In reviewing the sanctions imposed in this case, it should be borne in mind that the purpose of legislative enactments such as the securities acts and the Commodities Exchange Act is to protect the investing public. See SEC v. Ralston Purina Co., 346 U.S. 119, 124 (1953); Savage v.

CFTC, 548 F.2d 192, 197 (7th Cir. 1977).^{*} Therefore, as this Court has recognized, sanctions imposed pursuant to those acts should properly serve a remedial, as opposed to merely a punitive purpose. Berko v. SEC, 316 F.2d 137, 141 (2d Cir. 1963); Wright v. SEC, 112 F.2d 89, 94 (2d Cir. 1940).

The Commission's opinion in this case makes clear that the sanctions imposed upon Petitioners -- which on their very face are wholly disproportionate to the violations on which they purport to be based -- were meted out, not to protect the public, but as a muscle-flexing warning to a newly regulated industry. Thus, in an attempt to justify its harsh actions, the Commission stated:

"The Commission has received a mandate from Congress to establish order in and control over an industry unused to the feel of stringent government regulation. In this context, and at this stage of its existence, the Commission must make its expectations known to all and to assert its authority when called

^{*} As stated in the Senate Committee's Report on the 1974 amendments to the Commodity Exchange Act, Congress sought:

"To establish a regulatory authority in the commodity field similar to the Securities Exchange Commission and to give that agency a strong law which [would] enable it to regulate . . . in the public interest." Senate Comm. Rep. No.93-1131, 3 U.S. Code Cong. & Admin. News 5843, 5860 (1974).

for, lest it invite defiance from those subject to its regulations. . . . Suffice it to say that the Commission will not risk that the public at large will be exposed to commodity professionals who conduct business with callous disregard for the law. The highest ethical standards must prevail in every facet of the commodity options industry." (Opinion at 53; A-177)

These statements, and the severe sanctions they purport to justify, are wholly incongruous in the context of the present case, where the Commission has found that Petitioners did not engage in any "fraud, manipulation or breach of fiduciary responsibility" (Opinion at 55, A-179) and has further expressly held that:

" . . . there is no evidence in the record to establish that [Petitioners'] activities were conducted on, related to or had any adverse impact on trading conducted on any contract market." (Opinion at 56; A-180)

The Commission's concern with its authority and self-image may well have been influenced by the degree of public criticism that its actions during its two-year existence have brought upon it. A leading business journal has recently quoted a Congressional staff member familiar with the Commission as stating:

"The CFTC is a troubled agency from the management point of view We get no sense of where they are going or want to go, nor any sense of priorities." The Futures Regulator Comes Under Fire, Business Week, August 15, 1977 at 97.

The Business Week article went on to note that:

"In the past year, 40 staff members have resigned from the agency, including the general counsel, the head of the trading and markets division, and most recently, the second executive director that the agency has had." Id. at 98.

The article further quoted one former member of the Commission's staff as stating:

"There has been a real lack of leadership at the Commission level, and chaos throughout the agency." Id. (emphasis added).

Indeed, in an editorial in the same issue, Business Week affirmatively charged the Commission with "mismanagement." Chaos at the CFTC, Business Week, August 15, 1977 at 142.

The singling out of Petitioners* to serve as an "example" to the industry is made all the more ironic when considered in light of the fact that, in cases such as

* Significantly, the Commission's News Release #243-77, issued on January 17, 1977, stated that five options dealers had filed their FCM applications "late" and would not be permitted to do business after January 17, 1977. Lloyd Carr was not among the five. The release stated that Monex Trading Corp., one of the five, would be permitted to continue to do business for thirty days "pending further consideration by the [Commission] as to possible confusion between the name of this subsidiary and its parent firm" Petitioners also are advised that at least two other options dealers who were listed in that release as having filed late ("Bristol Options" and "International Commodity Options") continued to do business after January 17, 1977. Neither has yet been registered but, at least as of October 1, 1977, no public enforcement action had been taken against them.

Haltmier, supra, where there was a showing of actual fraud, the Commission was content to impose lesser sanctions. Significantly, in In re Siegel Trading Co., CCH Comm. Fut. L. Rep. ¶ 20,452 (CFTC 1977), the Commission let stand a decision by the very same Administrative Law Judge involved in this case, where he had held, in a case involving numerous instances of actual fraud, that:

"Revocation of STC's registration would certainly end any such [fraudulent] practice by STC, but the objective is to remedy problems throughout the industry and not capriciously destroy an ongoing business. If, through this enforcement action, STC complies with the letter and the spirit of the law in these matters, and pays a substantial penalty for violations occurring after April 21, 1975, then the Commodity Exchange Act is being properly administered. To put STC out of business, in the hope that this example would cause others to hew the line, is an unacceptable result."
¶ 20,452, at 21,849 (emphasis added).

The Commission's sanctions in this case are so harsh as to be punitive -- indeed, vindictive -- bearing no relation to the public interest. It is patently unfair that the Commission should have singled out Petitioners -- whose fair dealing and training program were never questioned by the Commission (Opinion at 52; A-176), and who admittedly had not committed "any fraud, manipulation or breach of fiduciary responsibility" (Opinion at 55; A-179) nor adversely affected trading "on any contract

market" (Opinion at 56; A-180) -- to be the targets of its most severe sanctions. In fact, if these harsh sanctions are left undisturbed, Petitioners' loyal and satisfied clientele would be left without the services of a commodity options dealer who had earned their trust, and the investing public at large would be left with one less proven honest and reputable dealer to whom they could turn. Compare CFTC v. Crown Colony Commodity Options, Ltd., 434 F. Supp. 911 (S.D.N.Y. 1977).

This Court only recently gave the Commission a clear direction with respect to the exercise of its punitive powers in Haltmier v. CFTC, 554 F.2d 556, 564 (2d Cir. 1977). There, although this Court upheld an eighteen month suspension in a context of fraud, it stated:

"Nevertheless, though we uphold the full sanction in this case, we remind the Commission that the Act does not compel it to impose across the board suspensions automatically whenever any violation is shown, and that it has, and should exercise, discretion in the individual case to determine how much of the full statutory remedy it should invoke. The agency's discretion as to the length of a suspension, extends also to the type and extent of any suspension, as well as to its choice among the various remedies the statute authorizes. . . . It would be well if the Commission revealed in its opinions that it had exercised the discretion it possesses. 554 F.2d at 564 (emphasis added; citation omitted)

Despite this clear admonition, the Commission stated in its Opinion in this case:

"We need not tarry long over the relationship between the violations and the sanctions imposed." (Opinion at 53; A-177)

The remedies imposed by the Commission here are wholly unrelated to the violations found. Petitioners submit that, at their expense the Commission has engaged in an act of administrative breast-beating that is unfairly punitive and vindictive, and bears no reasonable relationship to the Commission's proper task of protecting the public. This Court should not condone this manifest injustice.

CONCLUSION

For the reasons set forth herein, this Court should vacate the Commission's final order in this matter and direct the Commission to issue Petitioners a Futures Commission Merchant license.

Dated: New York, New York
October 19, 1977

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UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

CIVIL ACTION NO. 77-600-2

MASS., D. C.

James A. Carr. et alii

v.

Commodity Futures Trading Commission

APPEARANCES:

Messrs. Barrett & Lamont, Attorneys
for the Plaintiffs, by
G. Lamar Crittenden, Jr., Esquire.

Charles J. Wright, Esquire,
Attorney for the Plaintiffs.

Michael J. Stewart, Esquire,
Attorney for the Defendant.

Courtroom No. 7
Federal Building
Boston, Massachusetts
March 9, 1977

1 and try to answer a question that I have from the
2 jury.

3 MR. STEWART: Yes, your Honor.

4
5 (Recess.)

6
7 THE COURT: Okay. Now we can continue
8 with it. That was a quick question from the jury,
9 so now you are back.

10 Okay. Go ahead with your argument.

11 MR. STEWART: Mr. Hecht's next argument in
12 support of his assertion that he'd be irreparably
13 injured is that the setting of the time and place of
14 the hearing violates Commission Rule of Practice
15 10.61, since the defendant has no office in Boston.

16 Presumably this defendant, the CFTC and
17 the plaintiffs' witnesses - I don't know if he's
18 referring to his own CFTC or he is referring to
19 Commission employees that he apparently wishes to
20 call, although he hasn't attempted to subpoena them,
21 and that his law offices are in New York.

22 Well, with respect to that first, Rule
23 10.61 says the time and place shall be fixed with
24 due regard to the public interest and the convenience
25 and necessity of parties and their representatives.

1 And the respondent in this administrative
2 case is located here in Boston. Its books and
3 records are located here in Boston. Certain of its
4 employees are located here in Boston; other of its
5 employees are located in Greenwich, Connecticut.

6 Counsel for the Commission, although we
7 don't have an office here, is here in Boston. Certain
8 employees of the Commission who we will call and
9 perhaps Mr. Hecht would also like to call them, are
10 present here in Boston.

11 I will represent to this Court that I will
12 produce any Commission employee that he wants here in
13 Boston, so he is certainly not being irreparably in-
14 jured.

15 THE COURT: Let's stop at this point.

16 If he gives you a list of witnesses that
17 he wants, then you are going to stipulate that you
18 will produce them tomorrow without necessity of his
19 filing the motion that you talked about or any other
20 statements of expected testimony. I take it that is
21 what you have just represented to me.

22 MR. STEWART: I will represent to you,
23 your Honor, that if he tells me who he wants here,
24 I will get on the phone, and absent some extra-
25 ordinary circumstance, that they're out of the

1 country or that they're in the hospital, although
2 the Rules provide that he must subpoena them, I
3 don't know whether - I am probably violating my own
4 Rules, but I will have the people here.

5 THE COURT: Okay. Go ahead, continue.

6 MR. STEWART: And although he has made
7 this assertion, he hasn't filed any motion asking
8 that the place be changed. He has asked that the
9 proceeding be stayed, that a different date be set,
10 but he has filed no motion, no motion that this
11 hearing take place in Washington, D.C.

12 I submit that Boston is the correct venue
13 for this case, the administrative case.

14 And, finally, he says that a subpoena
15 that the Commission has issued on the respondent for
16 its books and records is unfair.

17 He has never moved under Commission Rule
18 of Practice 10.68(c), that is, the rule that tells
19 you how you go about moving to quash a subpoena,
20 never filed a motion to quash that subpoena.

21 He says that we are going to require them
22 to bring all these books and records over, but we
23 have a Rule requirement that says their books and
24 records must be kept current. He can address all of
25 those things to the Administrative Law Judge.

1 pre-arranged, and the judge wanted to hear the case
2 then.

3 I tried to work out with the staff a suit-
4 able schedule. Their answer was: The Commission's
5 order is the Commission's order, and we all had busy
6 trial schedules.

7 I tried it, unfortunately, to no avail.

8 All we are asking is a fair hearing and
9 there should be a judge there, according to their
10 normal rules. We are not prejudicing anyone. We
11 are not hurting anyone. We run a clean operation.

12 If, in fact, the Commission had facts to
13 support their fraud allegations, I presume they'd
14 put it in their complaint, but there is no fraud.

15 Their mistake was they brought a suit which
16 ended up in a successful injunction against the
17 corporation, against the defendants in Federal Court,
18 on regulations which, by the way, to show you how
19 ethically they acted, they filed in October and then
20 brought the injunctive suit. They have done every-
21 thing they can under the law.

22 That is the problem. The staff didn't
23 process their application. Now they're asking us to
24 pay the consequences.

25 THE COURT: All right. I am going to de...

1 the request for temporary relief, but I am also going
2 to consider as a stipulation that the Commission will
3 have available from day to day regardless of
4 whether the Commission intends to call those persons
5 as witnesses, any individuals that the plaintiff,
6 the Carr Company, lists as people that it intends to
7 call as witnesses.

8 That list will be given to the counsel for
9 the Commission prior to the lawyers leaving this
10 building today.

11 And I will consider that to be an order of
12 the Court based on a stipulation of counsel.

13 Do I correctly state the stipulation?

14 MR. STEWART: With one thing, that I am
15 just not quite sure what the Court means. You used
16 the term "day to day."

17 As I understand the stipulation, if
18 Mr. Hecht will tell me which Commission employees he
19 wants to call as witnesses, I will get on the phone -
20 I've still got time - alert those people, tell them
21 to make reservations and to get up here tomorrow.

22 THE COURT: And they will be available day
23 to day until the conclusion of the hearing.

24 MR. STEWART: They will be available when
25 he needs them, whether it's tomorrow - if it's going

1 to take us a day to put on our case, they can come
2 Thursday.

3 THE COURT: And then be available day to
4 day.

5 MR. STEWART: Obviously --

6 THE COURT: Look, do you understand what I
7 said? I said "day to day."

8 Do you understand what "day to day" means?

9 That means that they will be in Boston and
10 stay in Boston until the conclusion of the hearing.

11 Now do you understand that?

12 MR. STEWART: Well, I would ask that they
13 be in Boston until he is finished with them as
14 witnesses, and then they may leave.

15 THE COURT: That is what I meant.

16 MR. STEWART: Yes, your Honor.

17 THE COURT: Okay.

18 MR. HECHT: Your Honor, there is another
19 problem. I think that your order should cover
20 Commission records. The audit report of the staff on
21 January 20 and January 21 is a key document under --

22 THE COURT: Would you have it available?

23 MR. STEWART: Your Honor, I will represent
24 to the Court that I will give Mr. Hecht this after-
25 noon a copy of that audit report.

1 limited it.

2 We have asked for a request to limit the
3 subpoena, filed a motion; have not received a
4 response.

5 THE COURT: Let's take one problem at a
6 time. He has agreed that he will take copies, and
7 the same stipulation with respect to relevance would
8 apply to the records.

9 MR. HECHT: I have asked Mr. Levie to tell
10 us specifically what records he wants.

11 To get those records in, we would fill your
12 whole office. It's a business. They have branch
13 offices in St. Louis, --

14 THE COURT: Provide him with a list - not
15 this minute - provide him with a list; and, again,
16 if there are any questions as to relevance, they
17 may be treated later, either by me or, hopefully, who
18 ever is going to be hearing this case.

19 MR. STEWART: Who would hear argument on
20 the relevance, the Administrative Law Judge?

21 THE COURT: Ultimately I would because you
22 are making a stipulation in this Court.

23 In other words, you have stipulated in this
24 Court and that is an order of this Court.

25 So if others can't solve this problem,

1 which I consider to be a housekeeping problem, then
2 I suppose ultimately it may fall to me for no other
3 reason except that it is a stipulation entered into
4 before me and which is an order of this Court.

5 MR. STEWART: And I would further ask that
6 Mr. Hecht stipulate and represent to this Court that
7 he is going to produce those four employees of this
8 company who we have subpoenaed.

9 MR. HECHT: I only know of one, and it's
10 Mr. Schuster.

11 And one of the problems there is - as a
12 matter of fact he wrote Mr. Levie and said, "Please,
13 the company has a lawyer. They have contacted him.
14 A little rough on our employees. Would you please
15 contact our attorney?"

16 And at 10 o'clock this morning, Mr. Levie
17 and Mr. Stewart - Mr. Stewart called and got very
18 threatening, and the fellow was upset.

19 He said, "Look, what should I do?"

20 I said, "Come on up here. We will contest
21 the validity of the subpoena, but you should be
22 available because it wasn't properly served."

23 THE COURT: Will you have the four people
24 here?

25 MR. HECHT: I only know of one,

1 Mr. Carr, Mr. Schuster. I don't know about
2 Mr. Gawanne. I don't recall them all. I did request
3 a list of their witnesses.

4 THE COURT: Look, spare me the ancient
5 history. We are making some progress in this very
6 interesting case.

7 Go ahead. What else?

8 MR. HECHT: One thing, your Honor: I
9 prepared a TRO. Could someone endorse that the
10 motion was denied on the TRO so I can preserve my
11 rights?

12 THE COURT: If you hand it up, I will.

13 MR. HECHT: I have already given them a
14 copy.

15 THE COURT: This is an order. Where is the
16 motion?

17 MR. HECHT: You have the original there.

18 THE COURT: Okay.

19 What I have endorsed on the motion, for the
20 benefit of you and any reviewing body, is: After
21 hearing, the motion is denied, subject to stipulations
22 entered into by the parties in open Court. Such
23 stipulations are to be deemed an order of this Court.

24 Okay?

25 MR. HECHT: Your Honor, the second thing is:

1 There is a ministerial problem, and I have to bring
2 it to the attention of the Court. I brought it to
3 the attention of the law clerk for the Administrative
4 Law Judge: That I have a fixed appeal date to argue
5 Thursday afternoon before the Appellate Division in
6 New York and a fixed court thing which I have moved
7 back to 4:30 with the judge, Friday afternoon. He
8 feels that under his order - it says "without
9 interruption," and he has no jurisdiction.

10 THE COURT: What about going to the judge
11 that is expecting to see you in New York?

12 MR. HECHT: The Appellate Division is a five-
13 party thing. They don't adjourn appeals.

14 THE COURT: Why don't you go there and get
15 your order there? They can take care of themselves.

16 MR. HECHT: No. He won't release me. That
17 is why he pushed it back to 4:30.

18 THE COURT: Who won't release you?

19 MR. HECHT: The Administrative Law Judge
20 up here in this case. I asked him. I explained the
21 problem. I worked it out to push everything back to
22 late Friday afternoon. It's a trial, and the judge
23 in New York has agreed to hear the thing starting at
24 4:30 in the afternoon on Friday.

25 And when we went to the Administrative Law

1 Judge and said, "Here is my problem. I would like to
2 know that I would be available for these particular
3 hearings"; his answer was that under the Commission's
4 order, without interruption, he has no discretion and
5 he cannot release me.

6 THE COURT: Can't you appeal for some relief
7 or a protective order from the Court of Appeals, the
8 Appellate Division, whatever it is in New York?

9 MR. HECHT: Not on such short notice. They
10 don't adjourn it, and it involves the Attorney
11 General, and it's an important case, and they don't
12 want to adjourn it.

13 THE COURT: Can't you agree to adjourn
14 early?

15 MR. STEWART: Certainly.

16 You have to be there Friday afternoon?

17 MR. HECHT: And Thursday. Thursday at
18 2 o'clock. Friday at 4:30. They pushed it from the
19 morning to the afternoon. I figured that we are
20 starting here. I didn't know what your ruling would
21 be.

22 MR. STEWART: I couldn't agree to that. I
23 would agree to adjourn on Friday at noon so he could
24 be in New York Friday afternoon, argue whatever case,
25 to continue on Monday. I am getting piecemealed

1 here.

2 THE COURT: You are not getting piecemealed.

3 Did you ever deal with somebody that had
4 more than one case?

5 MR. STEWART: Oh, yes, I have, your Honor.

6 THE COURT: Do you have any doubts that he
7 is going to be appearing before somebody in New York
8 on Thursday?

9 If that is the case, if he can substantiate
10 to you that he is supposed to be before a proper
11 tribunal, a court of the State of New York on
12 Thursday, you won't recognize that as a legitimate
13 engagement and some exercise of comity toward a
14 state court?

15 I do here, the Supreme Court of the United
16 States constitution aside.

17 MR. STEWART: I am not questioning
18 Mr. Hecht when he tells me he has to be before the
19 court.

20 I am questioning - he's got a very busy
21 trial schedule. You've got to weigh that against the
22 need for the Commission to proceed, the need of the
23 public that the Commission proceed in this other
24 case.

25 THE COURT: As far as I know, he is asking

1 for two afternoons off, not to play golf but to
2 appear in court.

3 MR. STEWART: All right. Are you willing
4 to come back on Friday morning?

5 MR. HECHT: Yes. I said I would come back
6 Friday morning.

7 MR. STEWART: I am trying to find out what
8 you are willing to do.

9 MR. HECHT: That is what I spoke to your
10 staff before about.

11 THE COURT: Break at noontime so that he
12 can take care of his hearing on Thursday, come back
13 Thursday after that, be prepared to proceed on Friday;
14 break at noon, whatever, on Friday.

15 I suppose it doesn't have to be at noon.
16 Maybe at 1 o'clock. Break on Friday and then --

17 I will tell you, I feel like a babysitter
18 here this afternoon.

19 MR. STEWART: I'd like to state on the
20 record, in view of some of the Court's comments, that
21 our --

22 THE COURT: Which the Court does not
23 apologize for in any way, and I would defy any
24 Appellate Court to review this transcript and think
25 that I have exercised anything other than the utmost

'1 patience, after having a day where I have had any
2 number of hearings, including a jury trial, instructed
3 a jury; it's now 4:35; I have written an opinion, and
4 I am deciding questions of scheduling between two
5 lawyers; and I have never in my entire practice had
6 difficulty with scheduling the way I have seen you
7 two have difficulty with scheduling.

8 I think the only reason I am still here is
9 I am waiting for the jury to come downstairs; other-
10 wise, I think I would have walked off the bench a
11 long time ago and gone upstairs.

12 MR. HECHT: Your Honor, I tried to broach
13 them with this. All I can do is request, but it
14 takes two parties to agree, and that is the
15 problem.

16 THE COURT: You now agree that he can do
17 that?

18 MR. STEWART: Certainly, your Honor.

19 THE COURT: Okay. Anything else?

20 MR. HECHT: Your Honor, thank you for your
21 time and consideration.

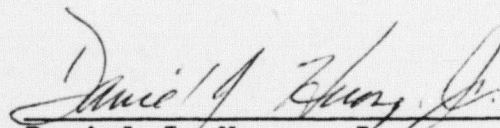
22 THE COURT: Thank you, both, for a most
23 interesting case.

24 (Whereupon, the hearing was adjourned.)
25

CERTIFICATE OF SERVICE

I certify that I have this day served upon the Respondent herein two copies of Petitioners' Brief and one copy of Petitioners' Appendix herein by mailing same, certified mail, return receipt requested, to Respondent Commodity Futures Trading Commission, Washington, D.C. 20581

Dated: New York, New York
October 19, 1977


Daniel J. Henry, Jr.

